FOR AGENDA

EBS/85/227

CONFIDENTIAL

September 27, 1985

To: Members of the Executive Board

From: *The Acting Secretary*

Subject: Costa Rica - Review Under Stand-By Arrangement and Request for Waiver of Performance Criterion

Attached for consideration by the Executive Directors is a paper on a review under the stand-by arrangement for Costa Rica and a request for a waiver of the performance criterion, which will be brought to the agenda for discussion on a date to be announced. Draft decisions appear on pages 15-17.

Mr. Elson (ext. 8500) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

COSTA RICA

Review Under Stand-By Arrangement and Request for Waiver of Performance Criterion

Prepared by the Western Hemisphere Department

(In consultation with the Exchange and Trade Relations, Fiscal Affairs, Legal, and Treasurer's Departments)

Approved by Eduardo Wiesner and Manuel Guitián

September 27, 1985

I. Introduction

A 13-month stand-by arrangement in an amount of SDR 54 million (59 percent of quota on an annual basis) was approved by the Fund for Costa Rica on March 13, 1985. To date, Costa Rica has made two purchases under that arrangement for a total amount of SDR 24 million (Table 1). A third purchase became available at the end of July 1985, but Costa Rica was unable to qualify for that purchase at that time because of the nonobservance of the quantitative performance criterion relating to external payments arrears, and since end August 1985 because of delays in completion of the review under the arrangement. In the attached letter dated September 19, 1985, the Minister of Finance and the Executive President of the Central Bank of Costa Rica request a waiver for the nonobservance of the performance criterion just mentioned and set out the lines of policy they intend to follow during the remainder of the stand-by arrangement.

The midterm review of the stand-by arrangement, which was intended to be completed by the Fund before August 31, 1985, is a performance criterion for the three remaining scheduled purchases under the stand-by arrangement, including the one which became available at the end of July and has not been purchased. In addition, the last scheduled purchase under the stand-by arrangement is subject to the completion of rescheduling agreements for the external public debt or the reaching of appropriate understandings on this subject with the Fund.

The 1985 Article IV consultation discussions with Costa Rica were conducted in the periods May 20-June 7 and July 10-17, 1985 and the consultation was concluded by the Executive Board on September 10, 1985 (EBM/85/136). The midterm review of the stand-by arrangement was initiated in the context of the 1985 Article IV consultation and the discussions were continued at Fund headquarters during August 21-23 and concluded in the period September 12-16, 1985.

Much of the material pertinent to the midterm review of the stand-by arrangement was included in the staff reports for the 1985 Article IV consultation (SM/85/223 and SM/85/247) recently considered by Executive Directors. Accordingly, this report describes the understandings reached in the latest discussions for the midterm review.

Table 1. Costa Rica: Fund Position During Period of Arrangement

	Outstanding Dec.31, 1984	1985 Jan.-Mar. Orig.	1985 Jan.-Mar. Act.	1985 Apr.-June Orig.	1985 Apr.-June Act.	1985 July-Sept. Orig.	1985 July-Sept. Rev.1/	1985 Oct.-Dec. Orig.	1985 Oct.-Dec. Rev.1/	1986 Jan.-Mar. Orig.	1986 Jan.-Mar. Rev.1/	1986 Apr. Rev.1/
(In millions of SDRs)												
Transactions under tranche policies (net)	--	12.7	12.7	6.7	6.7	10.0	--	7.0	7.0	10.0	10.0	7.8
Purchases	--	14.0	14.0	10.0	10.0	10.0	--	10.0	10.0	10.0	10.0	10.0
Ordinary resources	(--)	(7.0)	(7.0)	(5.0)	(5.0)	(5.0)	(--)	(5.0)	(5.0)	(5.0)	(5.0)	(5.0)
Enlarged access resources	(--)	(7.0)	(7.0)	(5.0)	(5.0)	(5.0)	(--)	(5.0)	(5.0)	(5.0)	(5.0)	(5.0)
Repurchases	--	-1.3	-1.3	-3.3	-3.3	--	--	-3.0	-3.0	--	--	-2.2
Ordinary resources	(--)	(-1.3)	(-1.3)	(-1.3)	(-1.3)	(--)	(--)	(-0.9)	(-0.9)	(--)	(--)	(-1.6)
Enlarged access resources	(--)	(--)	(--)	(-2.0)	(-2.0)	(--)	(--)	(-2.1)	(-2.1)	(--)	(--)	(-0.6)
Transactions under special facilities (net) 2/	--	-3.8		-3.8		-3.8		-3.8		-3.8		--
Purchases	--	--		--		--		--		--		--
Repurchases	--	-3.8		-3.8		-3.8		-3.8		-3.8		--
Total Fund credit outstanding (end of period)	159.0	167.9	167.9	170.8	170.8	177.0	167.0	180.2	170.2	186.4	176.4	184.2
Under tranche policies 2/	117.8	130.5	130.5	137.2	137.2	147.2	137.2	154.2	144.2	164.2	154.2	162.0
Special facilities 3/	41.2	37.4	37.4	33.6	33.6	29.8	29.8	26.0	26.0	22.2	22.2	22.2
(As percent of quota)												
Total Fund credit outstanding (end of period)	189.1	199.6	199.6	203.1	203.1	210.5	198.5	214.3	202.4	221.6	209.8	219.0
Under tranche policies 2/	140.1	155.2	155.2	163.1	163.1	175.0	163.1	183.3	171.5	195.2	183.4	192.6
Special facilities 3/	49.0	44.5	44.5	40.0	40.0	35.4	35.4	30.9	30.9	26.4	26.4	26.4

Source: IMF Treasurer's Department.

1/ Reflects Costa Rica's delay in making the purchase which became available at the end of July 1985 and the effect of the proposed rephasing.
2/ Includes outstanding use under EAR, SFF and EFF.
3/ Compensatory Financing Facility.

II. Review of the Program 1/

Through mid-September 1985, Costa Rica was in compliance with all the performance criteria of the stand-by arrangement with the exception of those related to external payments arrears and the completion of the midterm review (Table 2). As explained in the staff report for the 1985 Article IV consultation, Costa Rica did not meet the arrears test because of delays in the first disbursement of the World Bank's structural adjustment loan (SAL) and the final installment of the banks' new credit facility. Costa Rica was unable to complete the midterm review as scheduled because of delays in reaching understandings in the areas of fiscal and external sector policies.

The highlights of the Government's economic policies for the remainder of the stand-by arrangement, including the understandings in the policy areas just mentioned, are set out in the attached letter of the Minister of Finance and the Executive President of the Central Bank of Costa Rica dated September 19, 1985 (Attachment I) and are described in the remainder of this report. That letter also proposes certain modifications to the quantitative performance criteria of the present stand-by arrangement, as well as a waiver on the observance of the arrears test for Costa Rica's next purchase under the arrangement. In addition, the letter proposes a new performance criterion in the form of a special review of exchange rate policy to be completed by the Fund before Costa Rica's last purchase under the stand-by arrangement.

It also is proposed to rephase the final two scheduled purchases under the stand-by arrangement which become available at the end of October 1985 and January 1986 in order to align them more closely with the fiscal adjustment measures described below and to give more time for the completion of the review of exchange rate policy just mentioned. The proposed rephasing also reduces the time lag of more than two months which now exists between the date of the last scheduled purchase and the terminal date of the arrangement. In order to accommodate this rephasing of purchases, it is proposed to extend the terminal date of the arrangement from April 12, 1986 until April 30, 1986. These modifications to the arrangement are contained in the proposed decisions at the end of the report.

The fiscal, balance of payments, and macroeconomic projections for 1985 included in SM/85/223 were elaborated on the assumption that the understandings described below would be fully implemented. These projections are summarized in the table on selected economic and financial indicators in Appendix I.

1/ Recent developments and performance under the stand-by arrangement in the first half of 1985 were reviewed in detail in the staff reports for the 1985 Article IV consultation (SM/85/223 and SM/85/247).

Table 2. Costa Rica: Performance Under Stand-By Arrangement in 1985

	Mar. 31	June 28	Aug. 30	Prel. Sept. 17
		(In millions of colones)		
Net domestic assets of Central Bank				
Ceiling	18,300	18,500	17,890 1/	17,890 1/
Actual (Original definition)2/	16,196 3/	15,879	15,607	14,453
Margin or excess (-)	2,104	2,621	2,283	3,437
Ceiling	18,300	18,500	17,890 1/	17,890 1/
Actual (Revised definition)2/	17,014	18,170	18,429	17,084
Margin or excess (-)	1,286	330	-539	806
Net credit to public sector from the banking system				
Ceiling	17,300	17,300	17,100	17,100
Actual	16,168	15,429	15,527	15,566
Margin or excess (-)	1,132	1,871	1,573	1,534
		(In millions of U.S. dollars)		
Net international reserve position				
Target	-175	-165	-148	-148
Actual (Original definition)2/	-120 4/	-120	-107	-89
Margin or excess (-)	55	45	41	59
Target	-175	-165	-148	-148
Actual (Revised definition)2/	-136	-166	-164	-141
Margin or excess (-)	39	-1	-16	7
Stock of external payment arrears				
Limit	100	50	25	25
Actual	99	106 5/	109 6/	109 6/
Margin or excess (-)	1	-56	-84	-84
Foreign indebtedness of the public sector				
Short-term debt outstanding (excluding trade credits)				
Ceiling	3	3	3	3
Actual	--	--	--	...
Margin or excess (-)	3	3	3	...
New commitments with maturities 1-5 years				
Ceiling	25	25	25	25
Actual	--	--	--	...
Margin or excess (-)	25	25	25	...
New commitments with maturities 1-12 years				
Ceiling	50	50	50	50
Actual	--	--	--	...
Margin or excess (-)	50	50	50	...
		(In millions of colones)		
Cumulative central government expenditure commitments				
Target	7,640	17,710	28,685	28,685
Actual	7,790	17,284	22,709	...
Margin or excess (-)	-150	426	5,976	...

Source: Central Bank of Costa Rica.

1/ Ceilings adjusted downwards by US$22.2 million due to revisions to the stock of arrears outstanding in December 1984.

2/ Original and revised definitions refer to the exclusion or inclusion, respectively, of the increase during 1985 in the stock of dollar-denominated deposits of the rest of the banking system in the Central Bank as a foreign reserve liability.

3/ Reported figures were adjusted upwards by ₡2,096 million to reflect a float with respect to the payment of arrears at the end of the month.

4/ Reported figures were adjusted downwards by US$42.5 million to reflect a float with respect to the payment of arrears at the end of the month.

5/ Reported arrears figures were adjusted upwards by US$22.2 million to neutralize the effect of revisions to the stock of arrears outstanding in December 1984.

6/ Excludes US$12.2 million on account of bond arrears for which confirmed acceptance of the voluntary exchange offer is reported.

1. Fiscal policy

In the staff report for the 1985 Article IV consultation, it was reported that there had been deviations in the fiscal program because of a shortfall in revenues associated with weaker economic conditions than assumed in the program and expenditure overruns related to public sector wage adjustments in excess of what was agreed in the program. The Government also was unable to implement the planned adjustments in the domestic fuel prices of the National Petroleum Refinery (RECOPE). In the attached letter, the authorities describe a number of measures that they have implemented to ensure that the overall deficit of the nonfinancial public sector does not exceed the equivalent of 1½ percent of GDP targeted for 1985 and that the overall deficit on central government operations declines from 3 percent of GDP in 1984 to 1.7 percent of GDP in 1985 (Table 3).

To these ends, the authorities have introduced certain administrative measures to improve tax collections and have made cuts in authorized expenditures. In July 1985, a tax amnesty was established to collect arrears on income and consumption taxes, which yielded an estimated ₡ 500 million. The Government also has raised the penalty rate for new tax arrears, effective in November 1985, from a maximum of 24 percent a year to 40 percent a year.

Also, in July 1985, the Legislative Assembly approved budget cuts of ₡ 638 million, mainly for goods and services and current transfers, and in the remainder of the year the authorities intend to reduce expenditures by ₡ 2,000 million (around 1 percent of GDP) by means of administrative action. Of this amount, ₡ 1,250 million will represent underexecution of budget authorizations for salaries, other goods and services and transfers to the rest of the public sector, while ₡ 750 million in budgetary commitments, mainly for investment projects, will be postponed until next year. Of the proposed cuts by underexecution, ₡ 600 million was viewed as a contingency measure to offset possible shortfalls in the Government's campaign to collect back taxes, but since this campaign has yielded less than had been targeted, these cuts will also be implemented. The Government also has indicated that no further wage adjustments in the public sector will take place in the remainder of 1985 and that the adjustment in the first semester of 1986 will be strictly in accordance with the "basic basket" indicator agreed originally in the program. 1/

1/ This policy calls for semi-annual adjustments in public sector (and private sector minimum) wages in line with the increase in absolute terms in the value of a basic basket of goods and services for low income workers.

Table 3 . Costa Rica: Summary Operations of the Central Government

	1982	1983	1984	1985 Program	1985 Proj.
	(In millions of colones)				
Revenue	14,026	21,417	27,012	33,891	32,890
Expenditure	17,284	26,044	31,529	36,781	35,780
Current	(15,072)	(20,953)	(26,137)	(29,966)	(29,470)
Capital	(2,212)	(5,091)	(5,392)	(6,815)	(6,310)
Deficit	-3,258	-4,627	-4,517	-2,890	-2,890
	(In percent of GDP)				
Revenue	14.4	16.9	17.9	20.5	19.1
Expenditure	17.7	20.6	20.9	22.2	20.8
Current	(15.4)	(16.6)	(17.3)	(18.1)	(17.1)
Capital	(2.3)	(4.0)	(3.6)	(4.1)	(3.7)
Deficit	-3.3	-3.7	-3.0	-1.7	-1.7
Memorandum items					
Combined public sector deficit and Central Bank losses	-14.6	-8.1	-6.6	-5.8	-5.7
Nonfinancial public sector	-9.0	-3.1	-1.9	-1.5	-1.5
Central Government	(-3.3)	(-3.7)	(-3.0)	(-1.7)	(-1.7)
Rest of public sector	(-5.7)	(0.6)	(1.1)	(0.2)	(0.2)
Central Bank losses	-5.6	-5.0	-4.7	-4.3	-4.2

Sources: SM/85/223; Costa Rican authorities; and Fund staff estimates.

In the case of RECOPE, the authorities have indicated that because of political considerations it has not been possible to raise domestic fuel prices to compensate for increases in RECOPE's oil import costs, as called for in their letter of January 11, 1985. However, in order to prevent a deterioration in RECOPE's overall financial position, the authorities have introduced cost-saving measures to moderate the increase in its operating expenditures and have scaled down RECOPE's planned investment program. Also, RECOPE will refrain from increasing its inventories of strategic petroleum reserves, contrary to its original plan. With these modifications, it is estimated that RECOPE will generate an overall surplus of around ₡ 400 million in 1985, compared with one of ₡ 1.5 billion targeted in the program. This difference will be covered by a higher surplus in the operations of the decentralized entities, in particular the Social Security Institute (CCSS).

The authorities intend to continue the fiscal adjustment effort during 1986. To this effect, the Government has presented to the Legislative Assembly at the end of August 1985 a budget proposal for the next fiscal year beginning January 1, 1986 which involves an increase in authorized expenditures of 7 1/2 percent over the final budget for 1985. In the light of carry-over obligations from 1985 mentioned earlier, the lapsing of certain tax provisions at the end of 1985 and other adjustments to the budget to take account of extrabudgetary operations, it is projected that the overall deficit on central government operations for 1986 (before adjustment measures) could be on the order of 2 percent of GDP. However, in its Budget Submission the present Government 1/ has proposed that additional adjustment measures be undertaken to reduce the overall government deficit to around 1 percent of GDP next year.

In the attached letter, the authorities have indicated that they intend to submit a fiscal reform proposal to the Legislative Assembly before the end of October 1985. The purpose of this reform would be to establish more centralized control of public sector operations in the Ministry of Finance and to dismantle the complex system of revenue earmarking and compulsory spending which now exists. In the meantime, the authorities have taken certain actions to limit the scope of revenue earmarking in the annual budget exercise. Also, in September 1985, a law was enacted which incorporates most extrabudgetary operations (relating to transfers of earmarked revenues to certain decentralized institutions) in the Government's ordinary budget.

The authorities have taken measures to ensure that the net operational losses of the Central Bank do not exceed the equivalent of 4.2 percent of GDP in 1985. These measures include changes in the interest rate structure of the Central Bank; the application of charges that more than cover the service on foreign commercial indebtedness of

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1/ A new administration is scheduled to take office in May 1986 after elections in February.

the public sector assumed by the Central Bank in the 1983 Bank Rescheduling Agreement; and the negotiation of agreements with other Central American countries to convert unsettled balances in favor of Costa Rica in the Central American Clearing House into interest earning assets of the Central Bank of Costa Rica. As a result, the Central Bank is expected to increase its total earnings in 1985 by an estimated ₡ 860 million (0.5 percent of GDP). In addition, an agreement has been reached with U.S. AID whereby after September 1 no interest will be paid during the remainder of 1985 on the counterpart deposits of its grant assistance, thus reducing the potential operational costs to the Central Bank from this arrangement by around ₡ 800 million. In an effort to reduce losses further in the remainder of 1985, the Central Bank has begun to increase legal reserve requirements from an effective average rate of 25 percent to 30 percent on a gradual basis by the end of the year in order to offset a gradual reduction in the outstanding stock of central bank stabilization bonds which pay interest at 20 percent.

2. Monetary policy

On the basis of trends in bank credit operations during the first half of the year and prospects for the rest of the year, it appears that total bank credit will expand at a slower rate than originally envisaged in the program. This development reflects a smaller rate of accrual of private financial savings to the domestic banking system and a weaker demand for private sector credit because of the slackening in domestic economic activity now expected in 1985 (Table 4).

In the attached letter, the authorities have proposed the following adjustments to the monetary program. First, as regards the ceiling on net banking system credit to the nonfinancial public sector, it is proposed to introduce an adjustment clause (see footnote 1 of Table 2 in the attached letter) whereby the ceiling on such credit would be reduced by the extent of any transfers to the Central Government or reduction in the indebtedness of the National Development Corporation (CODESA) with the Central Bank arising from the sale of CODESA's subsidiaries. As mentioned in SM/85/223, the Government entered into an agreement with U.S. AID, which was not anticipated at the time the Fund program was finalized, whereby a portion of the domestic counterpart deposits generated from the grant assistance of U.S. AID would be used to cancel CODESA's liabilities with the Central Bank in the process of its divestiture. The proposed adjustment clause would ensure that the accounting operations just described would not give rise to a margin for credit expansion by the public sector under the program.

A second modification to the monetary program involves a change in the definition of the net international reserves of the Central Bank to treat the increase in the dollar-denominated deposits of the banking system in the Central Bank with respect to the stock at the end of 1984 as a foreign reserve liability for purposes of the balance of payments test and the net domestic assets ceiling. Most of these deposits accrue

Table 4. Costa Rica: Summary Operations of the Banking System

	December 31					June 30	
	₡ 45.00 = US$1		₡ 50.00 = US$1			₡ 50.00 = US$1	
	Recl. 1983 1/	1984	1984	Prog. 1985	Proj. 1985	1984	1985
	(In millions of colones)						
	I. Banking System						
Net international reserves 2/	-4,290	-7,539	-8,357	-5,621	-3,107	-8,768	-5,170
Net domestic assets	129,818	145,435	155,420	169,704	168,962	146,573	162,783
Net credit to public sector 3/	26,697	25,399	26,909	29,620	29,745	28,482 4/	28,190
Of which: subject to ceiling	(17,563)	(16,494)	(17,015)	(17,031)	(17,015)	(18,076)4/	(15,661)
Credit to private sector 5/	27,549	32,470	32,490	37,367	36,453	31,872	35,956
Other	73,758	82,238	90,101	102,717	102,764	83,056	94,722
Counterpart arrears	1,814	5,328	5,920	--	--	3,163	3,915
Government trust funds 6/	1,098	4,478	4,478	8,575	13,078	521	8,688
Long-term foreign liabilities 7/	69,998	72,889	80,988	86,296	83,788	78,825	83,784
Liabilities to private sector 5/	54,432	60,529	61,597	69,212	68,989	58,459	65,141
	II. Central Bank						
Net international reserves	-5,994	-7,777	-8,621	-5,621	-3,371	-10,039	-5,135
Official reserves	2,673	7,807	8,694	8,233	10,474	3,382	10,079
Payments arrears	-1,814	-6,498	-7,220	--	--	-3,326	-4,194
Rescheduling/revolving trade credit facility	-6,853	-9,086	-10,095	-13,854	-13,845	-10,095	-11,020
Net domestic assets	14,942	17,662	18,506	18,521	16,271	18,283	15,020
Net credit to public sector 3/	28,985	30,270	31,799	34,549	34,769	30,154 4/	34,580
Of which: rescheduling	(14,717)	(13,820)	(15,356)	(14,378)	(14,378)	(16,435)	(15,190)
Net credit to banks	-8,057	-10,195	-11,043	-7,989	-8,199	-7,215	-10,689
Of which: rescheduling	(4,119)	(1,307)	(1,452)	(2,660)	(2,560)	(4,665)	(2,560)
Government trust funds 6/	-1,098	-4,478	-4,478	-8,575	-13,078	-521	-8,688
Stabilization bonds	-5,090	-4,895	-4,895	-4,848	-5,613	-5,051	-6,683
Long-term foreign liabilities 7/	-68,127	-70,183	-77,981	-84,889	-82,381	-78,825	-84,008
Of which: rescheduled debt	(-21,330)	(-20,808)	(-23,120)	(-29,870)	(-29,870)	(-23,120)	(-29,870)
Other	66,515	71,815	79,184	90,273	90,773	76,578	86,593
Counterpart arrears	1,814	5,328	5,920	--	--	3,163	3,915
Currency issue	8,948	9,885	9,885	12,900	12,900	8,244	9,885
	(In percentage change)						
Banking system							
Net domestic assets 8/	36.2 9/	28.7		24.7	22.0		27.7
Net credit to public sector	3.3 9/	-4.9		10.0	10.5		-1.0
Of which: subject to ceiling	(3.3)9/	(-6.1)		(--)	(--)		(-13.4)
Credit to private sector	52.1 9/	17.9		14.0	12.2		12.8
Liabilities to private sector	30.3 9/	11.2		13.3	12.0		11.4
CPI (end-of-year)	10.7	17.4		10.0	11.0		14.8
	(As percent of GDP)						
Net credit to public sector	9.5	16.8		17.9	17.3		16.4
Credit to private sector	21.8	21.5		22.6	21.2		20.9
Liabilities to private sector 10/	37.6	38.0		38.2	38.2		38.0

Sources: Central Bank of Costa Rica; and Fund staff estimates.

1/ Reclassified; reflects the full effect of the rescheduling of payments arrears.
2/ Includes payments arrears.
3/ Includes exchange subsidies.
4/ Adjusted for credit to FERTICA which was only registered in October 1984 (₡ 824 million).
5/ Includes nonbank financial intermediaries.
6/ Includes counterpart of grants to the Central Government, in 1985 also of grants to the Central Bank.
7/ Includes counterpart of SDR allocation.
8/ In relation to liabilities to the private sector, at the beginning of the period.
9/ Changes based on foreign currency accounts valued at ₡ 41.40 per U.S. dollar.
10/ Ratio of two-year average of liabilities to the private sector, including liabilities to nonbank financial intermediaries, to GDP. Foreign currency deposits are valued at the actual end-of-year exchange rates.

to the Central Bank because they carry a 100 percent reserve requirement. Dollar-denominated deposits in the banking system have increased from US$198.5 million at the end of 1984 to US$255 million at the end of August 1985. As explained in SM/85/223, such deposits rose sharply in the first half of the year, at least in part, because of a large premium over LIBOR paid by the Central Bank on these deposits. By the end of July 1985, this premium had been reduced to around 1 percent which is the normal spread maintained in the past.

In the discussions for the midterm review, it was understood that Costa Rica's position under the quantitative tests of the program should be insulated from such inflows and that these deposits should be matched by an equivalent cover of foreign exchange. If this adjustment had been made earlier in the program, it would have had the effect of eliminating most of the margin under the balance of payments test and net domestic assets ceiling through June 1985 (see Table 2). Through the end of August, with this modification Costa Rica would not have been in compliance with the two performance criteria just mentioned. The deviation would have been less than the amount of the first disbursement from the World Bank structural adjustment loan which was expected to be received before the end of June 1985 and was not disbursed until early September 1985.

A third adjustment to the monetary program involves an upward revision to the targets for the net international reserves and a corresponding downward adjustment to the ceilings for the net domestic assets of the Central Bank to take account of a downward revision of US$22 million in the stock of external payments arrears outstanding at the end of 1984.

3. External sector policies

In the monetary program it is now projected that Costa Rica's potential inflows of net official capital may exceed program projections because of larger than expected disbursements of loans in the pipeline to the Central Bank from the World Bank and the Inter-American Development Bank, as well as certain concessional loans from bilateral creditors not contemplated in the program. As regards the World Bank SAL, a first disbursement of US$40 million was made on September 6, 1985 and a second (and final) disbursement of a similar amount is expected to take place before year-end after the World Bank completes a review of the SAL program.

A new money facility of US$75 million was established in the context of the rescheduling agreement with commercial banks signed at the end of May 1985; a first disbursement of US$18.75 million was made in late June 1985. The second (and final) disbursement under that facility was tied to the effective date of the SAL (August 23), as well as Costa Rica's continued compliance with the Fund program. Because the midterm review of the Fund program was not concluded before the end of August, which was the legal deadline established in the agreement with the banks for the second disbursement of the new money facility, Costa Rica was unable to make a second drawing under the facility. Costa Rica has requested an extension of this deadline until November 29, 1985. Once the extension is approved by the banks and Costa Rica's purchase rights under the stand-by arrangement have been restored by the completion of the midterm review, Costa Rica will be able to draw down the remainder of the new money facility and eliminate all remaining external arrears.

Costa Rica continues to maintain an exchange restriction in the form of payments arrears. A restriction arising from an unsettled claim with respect to a bank loan which arose in the context of the 1983 bank rescheduling agreement, and which had not been approved by the Fund in March 1985 when the current stand-by arrangement was approved, 1/ was eliminated by an agreement between Costa Rica and the bank in question in mid-September 1985.

In the attached letter, the Costa Rican authorities have reconfirmed their commitment to maintain a flexible exchange rate policy during the period of the stand-by arrangement. This commitment implies that periodic downward adjustments in the value of the colon will be made with a view to achieving a modest depreciation of the colon in real effective terms during 1985 and during the period of the stand-by arrangement. In the context of the discussions for the midterm review, an understanding was reached on conducting a special review on exchange rate policy to be completed by the Fund before Costa Rica's last purchase under the arrangement. That purchase was originally scheduled to become available on January 31, 1986, but it is now proposed to rephase this purchase until mid-April 1986 in which case the review of exchange rate policy would be completed before March 31, 1986. In order to give effect to the proposed rephasing, it is proposed in the decision on the stand-by review to extend the terminal date of the arrangement from April 12, 1986 until April 30, 1986.

III. Staff Appraisal

Purchases by Costa Rica under a stand-by arrangement approved by the Fund in March 1985 have been interrupted since the end of July because Costa Rica did not meet the arrears test and did not complete the midterm review. The lack of compliance with the arrears test would appear to be related, at least in part, to Costa Rica's delay in making the World Bank structural adjustment loan (SAL) effective and delays in the disbursement of the banks' new money facility. The SAL has now become effective and the disbursement of the new money facility is expected soon so that the deviation from the arrears test can be considered to be transitory. Therefore, Costa Rica's request for a waiver of the arrears test for the next scheduled purchase is justified. The temporariness of the deviation from the arrears test is evidenced by the

1/ This matter was discussed in EBS/85/31, Supplement 1.

completion of arrangements to secure the financing required for the program and by Costa Rica's having reached understandings with the Fund for the midterm review of the stand-by program, which give reasonable assurances that performance under the program will be on track.

In the fiscal area, a shortfall in government revenue related to weaker economic conditions than assumed in the program and expenditure overruns related to public sector wage increases in excess of the agreed indicator threatened to raise the overall fiscal deficit above the program limit. The Costa Rican authorities have reacted to these developments by adjusting downward the Government's overall expenditure program through effective cuts this year, but also by postponing expenditure commitments until next year, and by strengthening revenue collections through administrative improvements. On this basis, it would appear that the program target for the overall government deficit of 1.7 percent of GDP can still be attained. The staff would emphasize the critical importance of implementing fully the proposed expenditure cuts and minimizing the postponement of expenditure commitments until 1986 in order to prepare the ground for further fiscal adjustment.

In this connection, the fiscal reform which is intended to be submitted to the Legislative Assembly before the end of 1985 is welcome. This reform will eliminate the existing system of revenue earmarking and compulsory spending and will bring about a more centralized control of public sector operations in the Ministry of Finance. The recently approved budgetary reform to include most extrabudgetary operations in the Government's ordinary budget is an important step in the reform process.

In the rest of the public sector, the main concern has been the financial position of the National Petroleum Refinery (RECOPE) whose domestic fuel prices have remained fixed for the last two years, notwithstanding an increase in its import costs. In order to generate a small overall surplus in RECOPE's financial operations, the authorities have introduced cost-saving measures to restrain the growth in its operating expenditure, and will ensure that RECOPE's petroleum imports do not exceed the amounts needed to satisfy domestic demand. Nevertheless, the staff would encourage the authorities to review pricing policy in this area with a view to correcting the distortions in domestic fuel prices as soon as possible.

The authorities have taken steps to improve the interest earnings of the Central Bank and thus to ensure that operational losses are kept in line with program objectives. The staff welcomes this effort and the intention of the authorities to assign fiscal resources in the future to deal with this problem.

The staff notes the commitment of the authorities to maintain a flexible posture on exchange rate management in order to ensure that the external objectives of the program are attained. This policy also is critically important viewed against the perspective of the adjustment effort required of Costa Rica over the medium term to attain a manageable balance of payments position. The proposed special review on exchange rate policy will provide an opportunity for the Fund to examine the revised approach to policy in this area.

On the basis of the understandings reached in the discussions for the midterm review, the staff believes that Costa Rica's performance under the program will stay on track and that the overall objectives of the stand-by program will be obtained. Accordingly, the staff recommends the completion of the midterm review of the arrangement and approval of Costa Rica's request for a waiver, as well as its exchange restriction in the form of payments arrears until December 31, 1985.

IV. Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board:

I. Review Under Stand-By Arrangement

1. Costa Rica has consulted with the Fund in accordance with paragraph 4(c) of the stand-by arrangement for Costa Rica (EBS/85/31, Supplement 2) and paragraph 16 of the letter of January 11, 1985 attached to the stand-by arrangement, in order to review progress made in implementation of the program and to reach understandings on policies for the remaining period of the arrangement.

2. The letter of September 19, 1985 from the Executive President of the Central Bank of Costa Rica and the Minister of Finance shall be attached to the stand-by arrangement, and the letter of January 11, 1985, attached to the stand-by arrangement, shall be read as supplemented and modified by the letter of September 19, 1985.

3. Accordingly, the quantitative limits under paragraph 4(a)(i), (ii), and (iii) of the stand-by arrangement shall be read, for the remaining period of the arrangement, as subject to the adjustments and revisions set out in paragraphs 4 and 8 and further specified in Tables 2, 3, and 4 of the attached letter of September 19, 1985; the word ";or" shall be added to paragraph 4(e)(iv) of the stand-by arrangement and the following paragraph 4(f) shall be added to the stand-by arrangement:

(f) during any period after March 31, 1986 if the review contemplated in paragraph 8 of the attached letter of September 19, 1985 has not been completed, or if further understandings have been reached pursuant to the review, while such understandings are not being observed.

4. The period of the stand-by arrangement referred to in paragraph 1 of the stand-by arrangement, shall be extended until April 30, 1986.

5. Paragraph 2(a) of the stand-by arrangement shall be amended to read as follows:

(a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 14,000,000 until April 30, 1985, the equivalent of SDR 24,000,000 until October 31, 1985, the equivalent of SDR 34,000,000 until January 31, 1986, and the equivalent of SDR 44,000,000 until April 15, 1986.

6. The limit on the stock of external payments arrears referred to in paragraph 4(a)(iv) of the stand-by arrangement shall not apply to purchases under this stand-by arrangement that would not exceed the equivalent of SDR 34,000,000.

II. Approval of Exchange Restrictions

1. Costa Rica maintains restrictions on payments and transfers for current international transfers as described in EBS/85/227. In light of the implementation by Costa Rica of policies for balance of payments adjustment as described in the letter of September , 1985, attached to the stand-by arrangement (EBS/85/31, Supplement 2), the Fund grants approval for the retention of these restrictions until December 31, 1985.

Costa Rica: Selected Economic and Financial Indicators

	1982	1983	1984	Prog. 1985	Proj. 1985
(Annual percent change, unless otherwise specified)					
National income and prices					
GDP at constant prices	-7.5	2.4	6.3	3.0	-1.1
GDP deflator	86.4	24.0	12.7	10.0	14.8
Consumer prices (end of period)	81.8	10.7	17.4	10.0	11.0
(average)	90.1	32.7	11.9	11.0	14.0
External sector (on the basis of U.S. dollars)					
Exports, f.o.b.	-13.6	-0.8	10.8	9.9	-3.9
Imports, c.i.f.	-26.3	11.1	10.8	3.0	-5.8
Non-oil imports, c.i.f.	-33.0	13.1	14.5	4.6	-7.2
Export volume	-11.3	1.5	10.7	6.8	-4.5
Import volume	-24.3	15.9	11.5	1.1	-4.7
Terms of trade (deterioration -)	0.5	1.8	0.8	0.6	1.7
Nominal effective exchange rate					
(end of period; depreciation -)	-7.4	-4.7	-4.2	...	...
Real effective exchange rate					
(end of period; depreciation -)	60.0	-3.2	4.4	-2.5	-2.5
Government budget					
Revenue and grants	80.6	52.7	26.1	20.7	21.5
Total expenditure	60.5	50.7	21.1	15.5	13.2
Money and credit (banking system)					
Net domestic assets 1/	96.5	25.8	17.1	7.2	3.5
Public sector 1/	(8.7)	(0.9)	(-2.0)2/	(--)2/	(--)2/
Private sector 1/	(17.9)	(22.8)	(9.0)	(7.5)	(6.4)
Medium- and long-term foreign liabilities 1/	(8.8)	(12.4)	(11.5)3/	(16.4)3/	(18.5)3/
Counterpart arrears and others 1/	(78.7)	(14.5)	(22.0)	(12.9)	(10.9)
Liabilities to private sector (M_3)	50.5	30.3	11.2	13.3	12.0
Velocity (GDP relative to M_3)4/	2.9	2.7	2.6	2.5	2.6
Interest rate (annual rate, six-month					
time deposit)	25.0	22.0	20.0	20.0	21.0
(In percent of GDP)					
Overall public sector deficit					
(including Central Bank net losses)5/	14.6	8.1	6.6	5.8	5.7
Overall public sector deficit 5/	9.0	3.1	1.9	1.5	1.5
Central government savings	-1.0	0.3	0.6	2.4	1.9
Central government budget deficit 5/	3.3	3.7	3.0	1.7	1.7
Domestic financing	(1.0)	(1.9)	(1.1)	(0.8)	(0.8)
Foreign financing 5/	(2.3)	(1.8)	(1.9)	(0.9)	(0.9)
Gross domestic investment	16.6	21.7	23.1	22.4	23.0
Gross national savings	7.6	11.3	16.7	16.2	20.2
Current account balance (deficit -)	-9.0	-10.4	-6.4	-6.2	-2.8
Current account (excluding official transfers)	-9.3	-11.8	-9.6	-9.1	-9.0
Trade balance (deficit -)	-1.1	-4.0	-4.3	-2.1	-3.5
External debt inclusive of use					
of Fund credit	104.7	111.2	101.4	125.2	104.1
(In percent of exports of goods and services)					
Debt service ratio 6/	54.9	51.2	53.2	55.2	60.5
Interest payments 6/	29.7	27.7	24.6	26.5	26.1
(In millions of U.S. dollars)					
Overall balance of payments	-314	55	-110	60	105
Gross official reserves (months					
of imports)7/	3.3	3.7	4.6	4.2	5.2
External payments arrears	453	-1,070	174	-214	-214

Sources: Central Bank of Costa Rica; Ministry of Finance; and Fund staff estimates.

1/ Against the stock of liabilities to the private sector at the beginning of the period.

2/ Excludes credit growth arising from 1983 and 1985 long-term debt rescheduling and counterparts to U.S. AID grants and IBRD/SAL.

3/ Includes liabilities assumed under the 1983 and 1985 debt rescheduling and counterparts to U.S. AID grants and IBRD/SAL.

4/ GDP relative to the average of M_3 of the end of previous and current years.

5/ Includes accumulation of arrears.

6/ Inclusive of Fund charges and repurchases as well as interest on short-term debt. Includes unpaid interest and amortization; excludes the effect of debt rescheduling (1983-85).

7/ Includes nonliquid reserve assets, mainly claims against other Central American central banks.

Costa Rica - Fund Relations
(As of Ausust 31, 1985)

(Amounts in millions of SDRs, unless otherwise indicated)

I. Membership Status

(a) Date of membership: January 8, 1946
(b) Status: Article VIII

(A) Financial Relations

II. General Department

			Millions of SDRs	Percent of Quota
(a)	Quota: SDR 84.1 million.			
(b)	Total Fund holdings of colones:		256.3	304.7
(c)	Fund credit: Total		172.2	204.7
	Of which:	Credit Tranche	(58.4)	(69.4)
		CFF	(33.7)	(40.1)
		EAR	(57.9)	(68.8)
		Extended facility	(11.3)	(13.4)
		Supplementary facility	(11.0)	(13.1)
(d)	Reserve tranche position:		--	--
(e)	Current operation budget:		--	--
(f)	Lending to the Fund:		--	--

III. Current Stand-by Arrangement and Special Facilities

Type of Arrangement	Amount SDR Million	Amount Percent of Quota	Duration	Amount Drawn (SDR million)	Status
(a) Current stand-by arrangement:					
SBA	54.00	64.2	Mar.13, 1985- Apr.12, 1986	24.0	Temporarily suspended pending completion of review
(b) Previous stand-by and extended arrangements:					
SBA	92.25	150.0	Dec. 1982- Dec. 1983	92.25	Expired
EFF	276.75	450.0	June 1981- May 1984	22.5	Cancelled Dec. 1982
SBA	60.50	147.6	Mar. 1980- Feb. 1982	15.4	Cancelled June 1981
SBA	11.60	36.2	July 1976- July 1977	---	Expired

(c) Special facilities--
Compensatory financing:

	Date of Approval	Amount Drawn SDR Million	Percent of Quota
	Sept. 1983	18.60	30.2
	June 1981	30.10	48.9

IV. SDR Department

	Millions of SDRs	Percent of Allocation
(a) Net cumulative allocation:	23.7	100.0
(b) Holdings:	0.2	0.7
(c) Current designation plan:	--	--

V. Administered Accounts — None.

VI. Overdue Obligations to the Fund — None.

(B) Nonfinancial Relations

VII. Exchange rate arrangement: The representative exchange rate for the Costa Rican colon is the unified banking rate which is presently quoted at ₡ 51.95 (selling) per U.S. dollar. All transactions take place at this rate with the exception of the equivalent of 1/5 of 1 percent of export proceeds which are surrendered at the official rate of ₡ 20.00 per U.S. dollar, however, this does not give rise to a multiple currency practice under Article VIII, Section 3.

VIII. Last Article IV consultation: June-July 1985, completed by the Executive Board on September 10, 1985 (EBM/85/136), after a 12-month cycle. At present, Costa Rica's exchange restrictions are not approved by the Fund.

IX. Technical Assistance:

(a) CBD	None
(b) Fiscal	A FAD panel expert was assigned to the Ministry of Finance from August 1980 to December 1983, providing assistance principally in the area of budgetary procedures.
(c) Bureau of Statistics	Technical assistance missions to improve the reporting of monetary data were fielded in December 1984 and June 1985. In January 1985 a technical assistance mission on balance of payments accounting visited Costa Rica.

X. Resident Representative/Advisor: Mr. Ignacio Tampe has been the Fund's Resident Representative in San Jose since March 1984.

San Jose, Costa Rica
September 19, 1985

Mr. J. de Larosiere
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Larosiere:

1. In our letter to you of January 11, 1985, we indicated that we would review with the Fund the performance and the policies of our 1985-86 financial program before the end of August 1985. The purpose of this letter is to summarize recent developments under the program and the policies which the Government of Costa Rica intends to pursue during the remainder of the program period, in particular in the area of fiscal policy, exchange rate policy, CODESA's divestment program and fiscal reform.

2. Performance under the stand-by program to date has been satisfactory and Costa Rica was able to make its first purchase subject to quantitative performance criteria under the arrangement at the end of April 1985. As of the end of August 1985, Costa Rica was in compliance with all the performance criteria of the stand-by arrangement with the exception of the limit on external debt arrears. The failure to observe that limit was due mainly to the fact that there have been delays in the approval by the Costa Rican Legislative Assembly of the structural adjustment loan (SAL) from the World Bank which has made it impossible to disburse the first installment under the SAL of US$40 million and the bulk of the commercial banks' new money facility before the end of June, as had been contemplated in the program. For this reason the Government of Costa Rica wishes to request a waiver with respect to the program limit on external payments arrears in order to make the next scheduled purchase under the arrangement.

3. In the fiscal area, the Government's commitment is to reduce the overall public sector deficit (including the net losses of the Central Bank) to no more than 5.7 percent of GDP in 1985, of which the overall deficit of the nonfinancial public sector would be 1.5 percent of GDP and the net losses of the Central Bank would be 4.2 percent of GDP. At the level of the Central Administration, this result will be facilitated by a reduction in the overall government deficit from the equivalent of 3 percent of GDP in 1984 to 1 3/4 percent of GDP in 1985. In order to achieve this outcome, the Government is determined to maintain the growth in its expenditures within the limits set in the program, notwithstanding a higher than projected rate of inflation, and larger wage payments than contemplated in the program. To this effect,

budget cuts amounting to ₡ 638 million have been approved by the Legislative Assembly and cutbacks in investment outlays, other expenditures, and transfers to the rest of the public sector totalling ₡ 650 million are being implemented by administrative action. In addition, the Government does not intend to grant any further public sector wage adjustments in the remainder of 1985; in the first half of 1986 the public sector wage adjustment will be strictly in accordance with the absolute increase in the basic basket of essential goods and services ("canasta basica") for the previous six-month period. On the revenue side, steps have been taken to improve tax collections through administrative improvements (including the establishment of a tax amnesty and a substantial increase in the penalty rate for tax arrears) and by increasing transfers from entities in the rest of the public sector generating a surplus in accordance with the provisions of last year's Fiscal Equilibrium Law which were carried over to the current fiscal year. The Government has prepared a further contingency plan of budget cuts amounting to ₡ 600 million in case the amnesty mentioned above does not yield the desired amount. The Government also is prepared to adjust selective consumption duties to offset any revenue shortfall in the remainder of 1985 arising from the customs tariff reform which will be introduced after October 1, 1985.

4. In the rest of the public sector, the Government's intention is to achieve an overall surplus as was the case last year. This result will be reflected in a strengthening of the financial position of the main public sector entities outside the Central Administration, through appropriate pricing policies and expenditure control. In particular, the deficit of the Grain Marketing Agency (CNP) has been kept within the targets set for the program by means of cuts in its expenditure program and changes in the relative prices of its basic grain operations. In the case of CODESA, the Government has embarked on a major divestment campaign through sales of its major subsidiaries to a private sector trust funded with the local currency counterpart of grants to be received this year from U.S. AID. All the proceeds generated by these sales will be used to cancel CODESA's indebtedness with the Central Bank. In order to ensure that these operations are sterilized under the financial program supported by the Fund arrangement, the Government proposes to adjust downwards the ceiling on net credit of the banking system to the nonfinancial public sector by the full extent of any reduction in CODESA's indebtedness with the Central Bank or transfers to the Central Government arising from the sale of its subsidiaries. Accordingly, a revised version of Table 2 of our letter of January 11, 1985 is attached to this letter which incorporates this adjustment.

5. In 1986 the Government intends to make further progress in reducing the overall deficit of the public sector (including the net losses of the Central Bank). The Government also is committed to a reform of the public finances as a means of enhancing the effectiveness of fiscal policy over the medium term. To this effect, the Government intends to submit to the Legislative Assembly before the end of October 1985 a constitutional reform of the public finances which, among other

things, calls for the elimination of the existing system of revenue earmarking and the centralization in the Ministry of Finance of the budgetary process of entities outside the Central Administration. Pending the approval of this reform, the Government will make provision in the 1986 budget, as in the past two budgetary exercises, for the temporary reduction in the scope of revenue earmarking. Also, the Assembly has recently approved a budgetary reform whereby most extra-budgetary operations will be included in the Government's ordinary budget.

6. The authorities will continue to pursue a credit and monetary policy during the rest of the program period which is consistent with a strengthening of Costa Rica's net external position and the containment of inflationary pressures. To this effect, the Central Bank has been maintaining the expansion of bank credit below the limits set in the program. The Government also has revised its interest rate policy with a view to fostering the growth of colon-denominated financial savings and dampening the increase in foreign exchange deposits in the banking system. Furthermore, the Government has been taking measures to ensure that the Central Bank's net losses do not exceed 4.2 percent of GDP in 1985. In an effort to reduce these losses significantly in the future, the authorities are giving consideration to the incorporation of these losses in the fiscal program of the public sector by increasing government transfers to the Central Bank to offset their monetary impact.

7. The Government believes that prices in the economy should be determined by market forces. Some essential commodities, however, are subject to price controls, but arrangements have been in place to ensure that such controls are administered flexibly and adjusted on a timely basis to avoid the emergence of relative price distortions. Accordingly, at the beginning of July 1985, the Government raised the wholesale and retail prices of seven essential commodities by an average of 12 percent to ensure that local production costs are covered by domestic prices. In order to protect the income level of low-wage workers, the Government will adjust private sector minimum wages on a semi-annual basis by no more than the absolute increase registered in the official index of essential goods and services ("canasta basica") over the previous six-month period.

8. In the external sector, the Government is committed to achieve during the program period a significant improvement in the net international reserve position of the Central Bank and a reduction in the current account deficit of the balance of payments. The overperformance registered with respect to the net international reserve targets to date reflects basically an unanticipated accumulation of claims vis-a-vis the rest of Central America derived from a sharp improvement in Costa Rica's regional trade position and an exceptional inflow of private capital related to the growth of dollar-denominated deposits in the domestic banking system. In order to neutralize the effect of the latter foreign exchange inflows on performance under the program, the Government proposes to adjust the program definition of net international reserves for

the increase in the dollar-denominated liabilities of the Central Bank with the rest of the banking system above the stock outstanding as of December 1984. Accordingly, a revised version of Table 4 of our letter of January 11, 1985 is attached which incorporates in footnote 1 the proposed change in the definition of net international reserves. (This adjustment would also affect the measurement of the net international reserves for purposes of the net domestic asset ceilings set out in the attached Table 3.) Notwithstanding the developments mentioned above, the performance of Costa Rica's traditional exports outside the region this year has been weaker than anticipated, in part because of substantial weather-related damage to the banana sector and the cessation of production by a foreign banana corporation. The effects of this shortfall on Costa Rica's current account position are being compensated by a drive to promote nontraditional exports outside the region and a curtailment of imports below the level projected in the program. In order to facilitate these adjustments, the Government has been pursuing a flexible exchange rate policy whereby the colon has been depreciated from time to time in line with movements in domestic and foreign prices and developments in the balance of payments. The Government of Costa Rica will continue to adjust the value of the colon as needed to achieve the external objectives of the program and will review its exchange rate policy with the Fund again before March 31, 1986.

9. Since the date of approval of Costa Rica's stand-by arrangement from the Fund, the Government has secured the necessary external financing arrangements from its major foreign creditors. On April 22, 1985 the Government of Costa Rica negotiated an Agreed Minute with the Paris Club creditors which provides rescheduling in respect of principal and interest payments past due as of December 31, 1984 and those falling due during the period January 1, 1985 to March 31, 1986 amounting to US$168 million. The Government intends to conclude the bilateral agreements with the official creditors by no later than November 30, 1985. On May 30, 1985 the Government of Costa Rica signed a refinancing agreement with the foreign commercial banks providing debt relief on the order of US$280 million in respect of principal repayments falling due in 1985 and 1986. In addition, the banks have agreed to disburse a new money facility in the amount of US$75 million to facilitate the reduction of payments arrears, including interest obligations to the banks. The structural adjustment loan (SAL) was approved by the World Bank on April 16 and became effective on August 23, 1985. Under the SAL, the Government is committed to put into place by no later than October 1, 1985 a comprehensive tariff reform geared to the reduction of effective protection.

10. The Government believes that the policies set forth in this letter are adequate to achieve the objectives of the program, but will take any further measures that may become appropriate for this purpose. The Government will consult with the Fund on the adoption of

any measure that may be appropriate, in accordance with the policies of the Fund on such consultation.

Sincerely yours,

/s/
Porfirio Morera Batres
Minister of Finance

/s/
Eduardo Lizano Fait
Executive President
Central Bank of Costa Rica

Table 1. Costa Rica: Limits for Cumulative Central Government Expenditure 1/

(Cumulative amounts in millions of colones)

Periods	Limits
January 1, 1985 - March 31, 1985	7,640
January 1, 1985 - June 30, 1985	17,710
January 1, 1985 - September 30, 1985	28,685
January 1, 1985 - December 31, 1985	40,741
January 1, 1985 - March 31, 1986	48,500

1/ Defined as the sum of budgetary expenditures (gastos comprometidos y reconocidos) plus pending commitments (compromisos pendientes) plus extrabudgetary expenditure of the Central Government.

Table 2. Costa Rica: Ceilings on Domestic Banking System's Net Credit to the Nonfinancial Public Sector 1/

(Oustanding balances in millions of colones)

Periods	Ceilings
January 1, 1985 - March 31, 1985	17,300
April 1, 1985 - June 30, 1985	17,300
July 1, 1985 - September 30, 1985	17,100
October 1, 1985 - December 31, 1985	17,100
January 1, 1986 - March 31, 1986	17,300

1/ Defined as the difference between the banking system's gross credit to the nonfinancial public sector and the latter's deposits in the banking system. For this purpose, the nonfinancial public sector includes the Central Government, decentralized agencies and state enterprises. These ceilings exclude foreign loans from the Canadian International Development Agency (CIDA) to the nonfinancial public sector channelled through the Central Bank (up to US$4 million). Also, these ceilings will be reduced by the amount of counterpart funds from the IBRD structural adjustment loan (SAL) used by the Central Government, or by the amount of any transfers to the Central Government or reduction in CODESA's indebtedness with the Central Bank arising from the sale of CODESA's subsidiaries.

Table 3. Costa Rica: Ceilings on the Net Domestic Assets of the Central Bank 1/

(Outstanding balances in millions of colones)

Periods	Ceilings
January 1, 1985 - March 31, 1985	18,300
April 1, 1985 - June 30, 1985	18,500
July 1, 1985 - September 30, 1985	19,000
October 1, 1985 - December 31, 1985	19,750
January 1, 1986 - March 31, 1986	18,300

1/ Defined as the difference between the currency issue and the net international reserves of the Central Bank. These ceilings will be adjusted downward to the extent of any downward revision to the stock of payments arrears outstanding at the end of December 1984.

Table 4. Costa Rica: Targets for the Net International Reserve Position of the Central Bank 1/

(outstanding balances in millions of U.S. dollars)

Periods	Targets
January 1, 1985 - March 31, 1985	-175
April 1, 1985 - June 30, 1985	-165
July 1, 1985 - September 30, 1985	-170
October 1, 1985 - December 31, 1985	-140
January 1, 1986 - March 31, 1986	-115

1/ Defined as the difference between the Central Bank's gross foreign assets and short-term foreign liabilities including its net position with the Fund. Also included are any arrears on commercial payments and external debt service, as well as any increase in the stock of U.S. dollar-denominated deposits of the rest of the banking system in the Central Bank with respect to the position outstanding as of December 31, 1984 (US$198.5 million). These targets will be adjusted upward to the extent of any downward revision to the stock of payments arrears outstanding at the end of December 1984.

Table 5. Costa Rica: Limits for the Stock of Payments Arrears 1/

(In millions of U.S. dollars)

Periods	Limits
January 1, 1985 - March 31, 1985	100
April 1, 1985 - June 30, 1985	50
July 1, 1985 - September 30, 1985	25
October 1, 1985 - December 31, 1985	--
January 1, 1986 - March 31, 1986	--

1/ Defined as the stock of arrears on medium- and long-term external public debt (excluding amounts assumed to be rescheduled in 1985) plus the outstanding balance of deposits for foreign exchange requests held by the Central Bank of Costa Rica in excess of 15 days.